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# Dow Theory Letters

"The Market as Interpreted under the Dow Theory"

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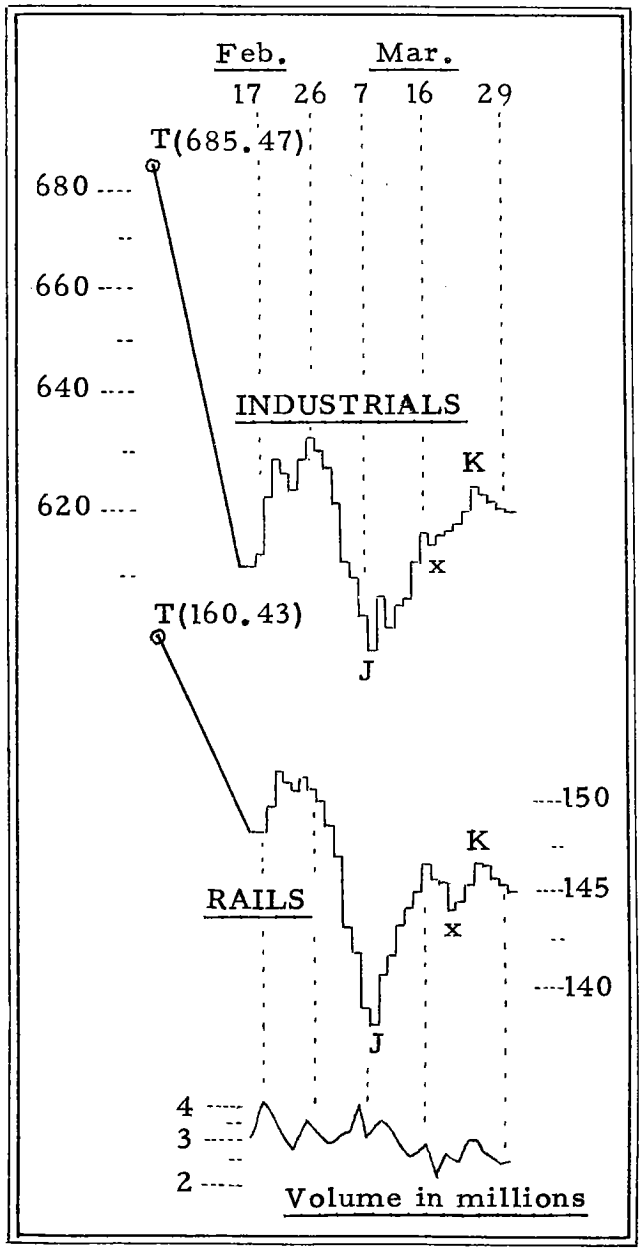
PRICE MOVEMENTS. In a study of nine bull and bear markets Rhea discovered the following rather remarkable facts: (1) for every 100 days of decline in bear markets there were about 86 days of advance, (2) for every 100 days of advance in bull markets there were about 76 days of decline. These figures suggest that whenever the days of advance or decline are too heavily weighted one way or the other, one can expect an averaging-out which will approximate the aforementioned statistics.

On the 44 day drop from T (685.47 on Industrials) to J (599.10), there were only 13 days of advance, and this suggested that the downside days were becoming too numerous. Following the low points at J the Industrials advanced on 10 out of 12 days. The Letter of March 12 noted, "On the basis of time alone a rally was overdue," and it is remarkable how consistently rallies do arrive (even in bear markets) when the normal ratio of advancing and declining days is "out-of-kilter". The ratio is well worth remembering and can be used as a guide over any extended period of time.




During the past 11 days the two Averages have fluctuated between the K points ( Industrials 624.00, Rails 146.56) and the minor decline lows at x (Industrials 615.09, Rails 143.98). In Letter 98 I mentioned that "lines" frequently form at the top of bear market rallies, and while it is still too early to know for certain, there is the possibility that a line is now being formed. A line denotes very evenly matched buying and selling, and the pattern of the Averages during a line formation should suggest equilibrium. The Rail Average at this time does seem to be in equilibrium, but Industrials still appear to be in a slight upward trend. If Industrials move down a bit closer to x and if the present formation lasts into next week (a line should last at least 15 trading days), I would say that we had a line structure in the Averages.

A simultaneous penetration by both Averages through either side of the line (particularly on increasing volume) usually provides a good prediction as to the next broad movement of the market. A penetration of one Average alone is meaningless, however, and is very apt to prove deceptive. Naturally, downside penetrations in bear markets carry more authority than do up-

side breakouts; the converse is true in bull markets.

The primary and secondary trends are down, while the minor trend is obscure. Should both Averages better the minor K peaks on increasing volume, the secondary trend will be pointing up. A joint violation of the decline lows at x would be quite bearish and would suggest a testing of the J points. In the event that a line is formed, it is well to remember that most lines are penetrated in the direction of the primary trend.

DOW'S THEORY. I have seen a few recent comments about "the old Dow-Hamilton-Rhea school of Dow Theory". Such references, of course, imply that the views of the men who created the Dow Theory are now antiquated, and that the Theory has since been "modernized" in keeping with "the new economy" and "the new way of thinking". This, to my mind, is pure nonsense. The work of Dow, Hamilton and Rhea is the Dow Theory, and any injections of extraneous matter or "new improvements" will inevitably turn the Theory into a "new animal". Perhaps the new animal will prove to be superior to the old one, but then -- why call it Dow's Theory?

The beauty of Dow's Theory of the price movements is that the Averages, by their very nature, adjust for everything, regardless of the time or place. During the next bull market, for instance, if rails ship only 35% of the total inter-city cargo instead of the present 46%, then it is possible that the price of the Rail Average will swing between 30 and perhaps 100. But that Average will still reflect relative forthcoming expansions or contractions in shipping.

"I do not believe," wrote Rhea, "that Dow's Theory, as explained and used by Hamilton, will ever be materially improved upon. Many have tried mixing it with statistics. Other attempt to detect a precision of detail and an exactness of forecasting implications which the price structure cannot and should not possess. When dogma is injected into the Theory the resulting mixture simply will not jell."

QUESTION. Are the movements of the D-J Utility and Bond Averages of any use in forecasting stock or economic trends?

ANSWER. I have made detailed studies of the movements of both of these Averages against the primary movements of the market. Inferences drawn from the movements of these two Averages play no part in Dow Theory and are as apt as not to be misleading. For instance, the long-term trend of the D-J 40 Bond Index has been down since 1946; bonds have been in an extended bear market in contrast to the 1949-59 bull market in stocks. The Utility movements can be equally deceptive: example -- the D-J Utility Average hit a low of 31.5 in early 1948, and then turned up against the 1948-49 bear market in Industrials and most other stocks.

QUESTION. How many phases are there in a bear market?

ANSWER. Just as there are three psychological phases in bull markets, there are also three phases in bear markets. These phases should not be confused with legs or swings; the latter are price movements and have nothing to do with phases. A study of last week's bear market listings will show that there may be any number of legs in a bear market (by definition there must be at least two).

During the first phase of a bear market stocks sell "ex" the hopes and expectations which accompanied the previous bull market's third phase. In the second phase, which is usually the longest, stocks go down in anticipation of deteriorating business conditions and diminishing corporate profits. The third phase of a bear market is the liquidation phase, and here people sell high-grade stocks because (1) they have to raise money for living expenses, and (2) there is little or no market for low-grade equities. In this last

phase the "blue-chips" collapse, and it is here, said Rhea, that people "who were saving for a rainy day" wake up to find that it is "raining".

We are currently in the first phase of a bear market which started on July 8, 1959. Stocks are now beginning to sell minus the froth of the "Golden Sixties" predictions (this is particularly true of the "backbone of the economy" stocks, i.e., autos, chemicals, steels, coppers).

CONFIDENCE INDEX HITS A 1959-60 LOW. Letter 84 provided a study of an interesting market indicator, the Barron's Confidence Index (C.I.). The C.I. is the ratio between Barron's 10 highest grade bonds and the broad D-J 40 Bond Average. When bond buyers (who represent the most sophisticated type of investors) turn cautious, they move into higher grade debt instruments such as the Barron's 10. When they are optimistic they will search for higher yields and accept lower grade debt such as the bonds which compose the D-J 40. The C.I. falls when Investors move into the high-grade bonds; it rises when they go into lower grade or more speculative debt.

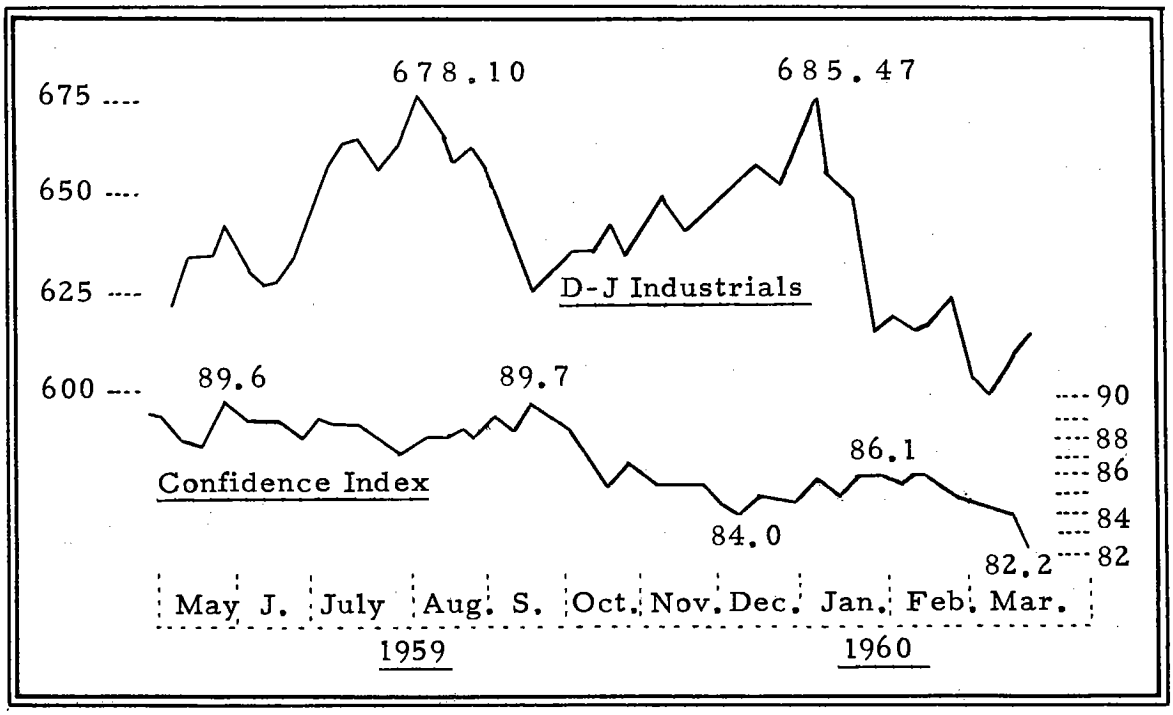
The movements of the C.I. Index generally precede the movements of the stock market by two to four months. In the last week of May, 1959 (see chart), the C.I. rose to a high of 89.6, then declined, only to hit a new high of 89.7 a few months later. These movements preceded the market rise in July, 1959, to 678.10 (Industrials), the drop in September to 616.45 and the subsequent advance to 685.47 in January, 1960.

In December, 1959, the C.I. dropped to a 1959 low of 84.0, and this preceded (I hesitate to use the word "predicted" because it smacks of magic) the March, 1960 lows of 599.10 on the D-J Industrials. Following the bear signal in the Averages, the C.I. drifted back to 86.1 and held there for a few weeks. Last week, however, the C.I. plunged a full two points to a new 1959-60 low of 82.2. Last week's drop (if one is to believe the C.I.) would suggest that subsequent to possible near-term firmness, new lows will be established by the market in the period ahead.

I spoke to Joseph Granville of E.F. Hutton this week (he has done the real work on the C.I. and is the expert on the subject), and according to him "any move back from the 599.10 (J) lows must now be viewed as transitory. The date for the probable new lows in the Averages must be placed between April 1 and June 1."

AROUND THE WORLD.

I have mentioned in the past that the primary (and most of the secondary) market movements are international in scope. The following paragraph is from an English correspondent, a man who is probably the most knowledgeable Dow Theorist in England today:



"In London I reckon we are still in a big bull market. Our high point was in early January, since when it (the market) has steadily declined, with a sharp 'bounce' rally since the 9th of March. But as volume has not expanded at all on the rally it does not seem to have much steam behind it, and I think the decline has further to go. So far it is only possible to say it is a secondary reaction in a bull market, which may possibly become the first primary leg of a bear market. We are well into the third phase of this bull market, so one must be on the tips of one's toes." J.F.D. Sussex, England (March 22, 1960)

And from a friend of mine (who is perhaps the best technician in Canada) comes the following: "As you can see from the Canadian charts, our market is distinctly bearish. I classify our group of 100 charts into 17 industries, 16 of which are bearish; the exception being the golds". I.F., Toronto, Canada (March 3, 1960)

The latter correspondent, who runs an excellent charting service in Canada, is kind enough to send me copies of his charts each week. I fully concur with his analysis, and perhaps this little clipping from the New York Times, March 27, 1960, bears out the chart story more eloquently than any words either of us could add.

**JOBLESS IN CANADA ARE POLITICAL ISSUE**

Special to The New York Times.

OTTAWA, March 26—Steadily mounting unemployment has presented the Canadian Government with one of the most difficult problems it has had to face since assuming office in 1957.

Figures issued this week by the Dominion Bureau of Statistics show that there were 550,000 persons out of work in Canada on Feb. 20, an increase of 51,000 in a month.

This means that 8.9 per cent of the nation's labor force of 6,218,000 is idle. In February last year, the total stood at 8.8 per cent and the labor force was 6,084,000.

The mounting unemployment figure has resulted in a heavy political attack on the Government inside Parliament.

GROUP RELATIVE STRENGTH. On the group charts we see Retail still acting better than the market, Office Equipment considerably better. Chemicals, Autos and Rubber are now acting worse than the market. Note the early "tip-off" and the Oil and Aircraft weakness -- their group relative strength turned down in 1958 (although the stocks were actually going up.)

STOCKS. The meat packing group has turned weak, Swift has broken below 45 which was strong support; Armour has cracked support at 36. In the poor looking metal fabrication group, Bridgeport Brass at a close of 33 and Revere Copper at a close of 44 would be in a position for shorting. Standard Packaging broke at 30 and looks weak as does W.R. Grace which broke major support at 43 and continues to look sloppy.

A VACATION! My wife and I are leaving on April 3 for Southern California, our first vacation in over two years. We will be away about nine days and hope to do a bit of "thawing out" in the famed California sun. My hobby (aside from the market) is the study of Cacti, and I plan to inspect some of the Opuntias, Mammilaria and such in the San Diego to Los Angeles area. Friends of mine tell me that only a Dow Theorist could be interested in Cacti -- I'm used to being kidded on both counts.

BOOKS. All the orders for Hamilton's "The Stock Market Barometer" have been shipped. The response was far above what I expected, so far, in fact, that I am considering reprinting two more books in the near future. I wish to thank readers again for their orders.

(Written March 31st, 2 P.M.)

GROUP RELATIVE STRENGTH CHARTS (courtesy of Traders Research, Inc.)